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LIBOR Left in Limbo; A Call for More Reform

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LIBOR Left in Limbo; A Call for More Reform

I. INTRODUCTION

Three hundred and sixty trillion dollars—that is the value of financial products worldwide that are indexed to the London Interbank Offered Rate (LIBOR), which is calculated daily by The British Bankers' Association (BBA).\(^1\) LIBOR is used to set interest rates for a wide spectrum of financial products\(^2\) and impacts nearly everyone, from governments to corporations to individual borrowers.\(^3\) LIBOR serves as the standard on which $900 billion in subprime mortgages, $9 trillion in global corporate debt, and countless other credit relationships depend to determine the interest rate borrowers must pay.\(^4\)

Imagine what could happen in a world where the integrity of the LIBOR calculation was wildly inaccurate—a place where purposeful manipulation or gross oversight left banks and borrowers to question the fundamentals of their credit relationship. The consequences could be staggering if the financial world discovered that the rate upon which many of its transactions were based was consistently inaccurate.\(^5\) Would courts find the terms of credit contracts unenforceable? Would years of litigation

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2. See Ben Levisohn & Lauren Young, The Lowdown on Libor, BUS. WK., June 9, 2008 at 80.
at an enormous cost result? Could this bring down an already unstable global financial market?

While it is impossible to predict exactly what impact such a scenario could have, one thing is certain: confidence in LIBOR is essential to both banks and borrowers. In the fall of 2008, LIBOR reached historic highs, both in actual terms and when compared to U.S. Treasuries of comparable maturities. Ironically, only a few months earlier in 2008, some expressed concern that LIBOR was not high enough because LIBOR panel banks had an incentive not to report their true estimated borrowing costs for fear of suggesting their own financial weakness. In response to this latter concern, the BBA undertook an expedited review of the reliability of LIBOR in May 2008.

In its review, the BBA sought suggestions from LIBOR users and published two documents that addressed the formulation of LIBOR, discussed proposed changes to LIBOR, and determined which proposed changes would be adopted. While the most comprehensive review in a decade provided great promise of change, the BBA's modifications to LIBOR were


10. Werdigier, supra note 1.


12. See BBA REPORT, supra note 3; BBA CONSULTATION, supra note 11.

minor and do not fundamentally address the significant reliability issues related to the perceived ability of banks to manipulate data. The most effective means to ensure reliability is for the BBA to mandate and undertake periodic sampling of actual transacted rates.

Part II of this note examines the development and computation of LIBOR, documents its growing importance to the financial world, and explains the basis of its calculation. Part III provides indicators during the first half of 2008 that suggest LIBOR is inaccurate. Part IV describes the BBA’s recent changes to LIBOR. Part V and Part VI critically analyze those changes and suggest that in order for reliability to be ensured more measures need to be taken.

II. LIBOR COMPUTATION

LIBOR, which was created by the not-for-profit BBA, is “the rate at which banks borrow or lend funds to each other in the London money market.” It was first formulated in 1985 as a means for lenders to fix their lending interest rates to a reference rate in order to ensure that they were lending at a rate above their borrowing costs. For example, a lender and a borrower may agree to an adjustable rate loan that has an interest rate at LIBOR

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15. See id. (suggesting independent supervision and periodic controls); Gavin Finch & Ben Livesey, LIBOR Overhaul May Fail to Restore Confidence in Rate (Update2), BLOOMBERG, June 11, 2008, http://www.bloomberg.com/apps/news?pid=20601109&sid=aP.rmBC0WuXA&refer=home (quoting Marius Daheim, Senior Bond Stratigist Bayerische Landesbank suggesting BBA should require banks to submit actual transacted rates).

16. See infra notes 20-41 and accompanying text.

17. See infra notes 42-69 and accompanying text.

18. See infra notes 70-127 and accompanying text.

19. See infra notes 128-168 and accompanying text.

20. BBA REPORT, supra note 3, § 1.2.

21. Laurenti, supra note 5.

22. BBA REPORT, supra note 3, § 2.3.

plus a certain percentage. The rate paid on the loan would adjust periodically according to the contract terms and LIBOR at the time of adjustment.

The LIBOR calculation process is supervised by the BBA’s Foreign Exchange and Money Market Committee (FX & MM Committee) and is calculated for ten global currencies including the Australian, Canadian and U.S. Dollar, the U.K. Pound Sterling, the Euro, and the Japanese Yen. The U.S. dollar LIBOR is the focus of this article.

For each currency, the BBA forms a panel of “contributor banks” based upon an annual survey determining which institutions “are active in the London market in the relevant currencies and in reasonable amounts.” There are sixteen banks on the U.S. dollar LIBOR bank panel, but only three are from the United States: Bank of America, Citibank NA, and JP Morgan Chase. The other thirteen contributor banks are headquartered in Asia, Europe or Canada. Inclusion on the bank panel is based on fixed standards that require interest rate data to come from transactions in London and not at another location. As a result, there are well known banks within countries that are not significantly active in London to qualify for inclusion on a specific LIBOR panel.

In calculating LIBOR, a contributor bank submits the rate at which it believes it “could borrow funds” were it to do so by

25. Id.
26. BBA REPORT, supra note 3, § 3.2.
27. Id. § 3.4.
28. For simplification purposes, the U.S. dollar LIBOR is the focus of this article.
29. BBA REPORT, supra note 3, § 3.1.
30. See id. § App. 1 (listing banks on each contributor panel).
32. BBA CONSULTATION, supra note 11, § 3.12.
33. BBA REPORT, supra note 3, § 3.1 (for example, many notable U.S. banks are absent from the U.S. dollar LIBOR panel).
34. See BBA CONSULTATION, supra note 11, § 3.12 (Funds are unsecured interbank cash or cash raised through primary issuance of interbank Certificates of Deposit) (quotation omitted).
asking for and then accepting inter-bank offers in a reasonable market size.” 35 This calculation is undertaken at 11A.M. London time36 and is formulated in numerous loan durations, with the shortest being overnight and the longest being one year.37 The LIBOR calculation removes the upper and lower data quartiles from the calculation38 to eliminate outlying data and minimize the risk that a particular bank could purposefully report false data to influence the rate.39

The public may access and view the data that banks contribute to the formulation of LIBOR on the BBA’s website.40 The BBA asserts that the transparency provided by releasing the data is one of LIBOR’s most important characteristics and believes that reliability is enhanced when market participants know the source of data in the LIBOR computation.41

III. CONCERNS REGARDING LIBOR’S COMPUTATION

A. Evidence of a Problem: LIBOR’s Confused Correlation

LIBOR was an accurate measure of the cost of borrowing between banks when it was introduced in 1985.42 In fact, LIBOR was so entrenched in the financial system that it went largely unquestioned.43 Numerous sources in the financial markets raised credibility issues with LIBOR at the beginning of the so called “credit crisis” in the summer of 2007.44 The BBA did not acknowledge that any true LIBOR credibility problem existed yet explained that the economic situation had led to “the breakdown of longstanding correlations,” which led to widespread inaccuracies in media coverage.45 The BBA nonetheless

35. BBA REPORT, supra note 3, § 12.2.
36. Id.
37. Mollenkamp, supra note 23.
38. BBA REPORT, supra note 3, § 10.1.
39. Id. § 3.3.
40. Werdigier, supra note 1.
41. BBA REPORT, supra note 3, §§ Executive Summary, 11.1.
42. Euromoney, A Benchmark or a Rate?, EUROMONEY, July 2008.
43. Mollenkamp, supra note 23.
44. See, e.g., Peter Taylor, Fears Grow Over Libor Reliability, DAILY TELEGRAPH, Apr. 17, 2008 § City, at 1.
45. BBA REPORT, supra note 3, §§ 2.3-2.4, 11.1.
undertook the review of LIBOR to bolster confidence in the rate and to determine whether the benchmark needed to be modified to take into account lessons from the tumultuous market.\(^{46}\)

For this article, the significance of the BBA review is not that it demonstrated that there was *in fact* a problem with LIBOR, but rather that the *perception* of a problem compelled the BBA to address reliability.\(^{47}\) An in-depth analysis of the validity of the indicators that suggested problems with the computation of LIBOR is, thus, beyond the scope of this article. Without analyzing the intricacies or the validity, the factors that raised concern are discussed below.

1. The Spread between LIBOR and Overnight Index Swaps

As a reflection of LIBOR’s credibility, the spread between the overnight index swaps (OIS)\(^{48}\) and LIBOR averaged twenty five basis points\(^ {49}\) until the end of the 1990s.\(^ {50}\) During the last decade, the spread compressed to between eight and ten basis points as a result of the U.S. Federal Reserve’s loose monetary policy.\(^ {51}\) Between 2001 and July 2007, when the global credit crisis began, the spread averaged eleven basis points.\(^ {52}\) In July 2008, the gap between LIBOR and the OIS approached 100 basis points, a figure significantly lower than the spread from a year prior.\(^ {53}\) In October 2008, it peaked at 366 basis points (so large that it is just referred to as 3.6%), then receded somewhat in November 2008 to 209 basis points, far above the pre-crisis level.\(^ {54}\)

46. BBA CONSULTATION, *supra* note 11, § 2.4.
47. See generally BBA CONSULTATION, *supra* note 11 (where the BBA recognizes reliability questions raised), BBA REPORT, *supra* note 3 (where the BBA recognizes reliability questions raised).
49. A basis point is “One-hundredth of 1%; .01%.” *Black’s Law Dictionary* 145-46 (7th Ed. 1999).
50. Euromoney, *supra* note 42.
51. Id.
2. The Spread between Treasuries and LIBOR

Much like the OIS-LIBOR situation, the spread between the yield on a three-month treasury bill and the three-month LIBOR (known as the TED spread)\(^5\) made a similar departure from historic norms.\(^6\) In 2007 the TED Spread was in the twenties.\(^7\) By mid-October 2008 it was more than 400 basis points, a level higher than at any time since the stock market crash of 1987.\(^8\)

3. The Default Insurance Market

The cost of bank default insurance\(^9\) has generally been positively correlated with LIBOR.\(^10\) That is, in times when banks were thought to be healthy, both the cost of bank insurance and LIBOR decreased or remained low, but when banks were thought to be in poor condition, both increased.\(^11\) Beginning in early 2008, however, the positive correlation between LIBOR and default insurance costs began to disappear with each moving seemingly independent of the other.\(^12\)

B. An Incentive to Cheat: Misrepresenting True Borrowing Costs

The perceived LIBOR irregularities described in Part A above\(^13\) focused attention on the possibility that contributor banks

\(^{55}\) But Will it Work?; Rescuing the Banks, ECONOMIST, Oct. 18, 2008.
\(^{56}\) Id.
\(^{57}\) Id.
\(^{59}\) See Carrick Mollenkamp & Mark Whitehouse, Study Casts Doubt on Key Rate—WSJ Analysis Sugests Banks May Have Reported Flawed Interest Data to LIBOR, WALL ST. J., May 29, 2008, at A1 (noting that bank default insurance is an insurance product that protects against the risk of a bank defaulting on the bank’s debt.).
\(^{60}\) Id.
\(^{61}\) Id.
\(^{62}\) Id.
\(^{63}\) See supra notes 42-62 and accompanying text.
might be purposefully misrepresenting data. It was suggested that during times of financial instability, contributing banks have the incentive to report rates similar to other contributing banks to ensure that they do not stand out, thus giving the appearance of financial distress. Reporting high borrowing suggests that a bank is too financially strained to borrow money at a rate comparable to its peers. Thus, a bank may avoid this alarm-causing perception by under-reporting such rates. While the BBA did not admit that it believed LIBOR had been the subject of purposeful misrepresentation, the level of concern was significant enough that the BBA issued a statement in April 2008 that it would ban any bank that manipulated data.

IV. ALTERNATIVE SOLUTIONS CONSIDERED BY THE BBA

While the LIBOR review process took place in the midst of an unfolding financial crisis, the BBA was committed to a long-term view, in an effort to avoid overreacting to the short-term market conditions. One reason the BBA took this long-term approach is that significant modifications to the LIBOR calculation could have sent innumerable contracts into legal uncertainty while their validity was determined. In this scenario, the BBA could have faced legal challenges from both borrowers and lenders who held contracts tied to LIBOR. While the BBA has suggested that the creation of additional LIBOR fixes would create confusion, it is possible that the BBA could report two LIBOR rates—those for contracts entered into before a reform’s effective date and those entered into after the effective date. This

64. See, e.g., Taylor, supra note 44.
65. Mollenkamp & Whitehouse, supra note 59.
66. Barr & Twaronite, supra note 6.
67. Id.
69. Finch & Livesey, supra note 9.
70. BBA CONSULTATION, supra note 11, §§ 2.4 - 2.5.
71. Carrick Mollenkamp & Alistair MacDonald, More Banks Will Contribute to Key Libor Rate, GLOBE AND MAIL, June 11, 2008, at B10.
72. Id.
73. BBA CONSULTATION, supra note 11, § 3.2.
solution could only be effective over the long-term as it would apply to new contracts, but would not affect the current situation.

With these considerations in mind, the BBA evaluated a number of alternative solutions:

A. Unverified Transparency

Contributing bank data are publicly released\(^74\) causing some to believe that the lack of anonymity may contribute to the perception that banks falsify true borrowing costs.\(^75\) This "transparency" may result "in contributors exhibiting 'herd' behaviour [sic],"\(^76\) where banks are reluctant to report rates higher than their peers for fear of appearing in financial distress.\(^77\)

The BBA considered a possible solution to this herd behavior problem could be to "anonymise [sic] contributions, by ceasing to publish the underlying inputs from contributing banks freeing them to publish a rate without fear of this attracting attention."\(^78\) A majority of financial institutions surveyed by the BBA, however, believed that such a change would not be beneficial.\(^79\) In addition, the BBA strongly reasserted that "the strength and popularity" of LIBOR directly result from the transparent calculation method including the public release of contributing bank data.\(^80\)

Thus, despite concerns over problems that may be created by LIBOR's transparency, the BBA rejected the call for anonymity and took no direct action to change the policy of

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\(^74\) Werdigier, *supra* note 1.

\(^75\) Krebsach, *supra* note 13; Finch & Livesey, *supra* note 9 (quoting Tim Bond, Head of Asset Allocation Strategy and Barclays Capital, "LIBOR rates would be more reliable if banks offered rates anonymously, removing the stigma of appearing like they are having trouble accessing capital."); Ben Livesey & Gavin Finch, *LIBOR to be Set by More Banks as BBA Boosts Scrutiny (Update4)*, BLOOMBERG, June 10, 2008, available at http://www.bloomberg.com/apps/news?pid=20601087&sid=a.kQFW9Ebh4&refer=home (noting "Zurich-based UBS, the world's largest wealth manager, advocated calculating the rate later in the day, while Barclays Capital said rates should be based on anonymous quotes").

\(^76\) BBA REPORT, *supra* note 3, § 11.1.

\(^77\) See Barr & Twaronite, *supra* note 6.

\(^78\) BBA REPORT, *supra* note 3, § 11.1.

\(^79\) *Id.*

\(^80\) *Id.*
making contributing banks' data available to the public. The BBA did, however, implement other changes to the LIBOR calculation process which are the subject of consideration below. The question remains whether these changes adequately address the significant reliability issues that result from the perceived ability of contributing banks to misrepresent data.

B. Creating an Additional U.S. Dollar Benchmark Fix

The BBA sought input on whether it should calculate a second U.S. Dollar LIBOR to be formulated at a time after markets open in New York. This second LIBOR formulation would have the advantage of being calculated when transactions in New York were actually taking place rather than at 11 A.M. London time, when New York was still closed for business. This second formulation would not eliminate the problem with banks' ability to manipulate data if the means for calculating it remained the same. Changing the calculation method for a second LIBOR to offer bank-anonymity or posting of actual transacted rates might offer a solution yet the BBA did not analyze this possibility. Instead, the BBA rejected the idea of a second LIBOR calculation and decided that it would "cause confusion in the market and involve revisiting the definition for LIBOR used in many existing agreements." That is, banks and borrowers would be wary of a change to LIBOR's calculation because of the

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81. See BBA REPORT, supra note 3, § 11.2.
84. Id.
85. See generally Mollenkamp & Whitehouse, supra note 59 (noting bank may occur because of the method of calculation, not the timing of calculation).
86. See generally Mollenkamp & Whitehouse, supra note 59 (noting bank may occur because of the method of calculation, not the timing of calculation).
87. See BBA REPORT, supra note 3, § 11.2 (discussing anonymity as a solution); Finch & Livesey, supra note 15.
88. See generally BBA REPORT, supra note 3 (showing an absence of consideration of this subject).
consequences it would have for the numerous financial instruments already tied to the rate.\textsuperscript{90}

C. Expanding Current BBA LIBOR Panels

The BBA reaffirmed that any bank could join a LIBOR panel so long as it met specific criterion.\textsuperscript{91} This criterion requires that to qualify for inclusion in a panel, any prospective bank must demonstrate that the value of its lending and swap activity carried out in London is in a significant amount.\textsuperscript{92} The BBA noted that the current composition of the panel represented a “substantial majority” of London activity and that it was “unaware of any sizeable players” that were not already represented on the panel.\textsuperscript{93} The BBA nonetheless declared that it would engage with major banks to examine their qualifications for inclusion in the LIBOR computation.\textsuperscript{94} The BBA also indicated that it would be willing to increase the size of the LIBOR panel if such banks were found.\textsuperscript{95} Whether the BBA will find any new banks that meet its criterion or whether any will in fact be added remains unclear at this point.\textsuperscript{96}

The BBA also asserted that adding smaller players to the panel would not significantly impact the calculation of LIBOR because those players would not be active in the London market in large enough quantities.\textsuperscript{97} Some, however, argue that in the aggregate, the volume of smaller banks’ London transactions is significant.\textsuperscript{98} They suggest that as a sum total, the inclusion of smaller banks would help to increase market coverage thereby making LIBOR more accurate.\textsuperscript{99} In addition, adding to the

\textsuperscript{90} Werdigier, supra note 1.
\textsuperscript{91} BBA REPORT, supra note 3, § 8.3.
\textsuperscript{92} Id.
\textsuperscript{93} Id.
\textsuperscript{94} Id., § 13.5.
\textsuperscript{95} Id.
\textsuperscript{96} Compare Finch & Livesey, supra note 15 (noting the BBA “plans to increase the number of banks that set the LIBOR”), with Laurence Norman, International Finance: Changes to LIBOR Rejected---U.K. Bankers Group Sticks to Definition of Rate Benchmark, WALL ST. J., Aug. 6, 2008, at C2 (noting the BBA would consider increasing panels but no banks had asked to join).
\textsuperscript{97} BBA CONSULTATION, supra note 11, § 3.6.
\textsuperscript{98} See id. § 3.7.
\textsuperscript{99} Id.
contributor panel would also lessen the effect of outlier rates by increasing the pool of data. Notable, though, is that increasing the LIBOR panel does not address the herd mentality problem that allegedly results from banks’ incentive to collectively provide false data to assure the markets that they are as financially sound as the other banks in the panel.

D. **Tightening the Definition of Reasonable Market Size**

LIBOR is the “rate at which an individual Contributor Panel bank could borrow funds, were it to do so by asking for and then accepting inter-bank offers in reasonable market size.” The term “reasonable market size” is not defined and the BBA notes that this is intentional because “reasonable market size will vary according to prevailing liquidity and credit conditions as well as between currencies.” The BBA reasoned that a stricter definition could result in confusion and further liquidity problems. As a result, the BBA decided not to change the term or add further definition.

Most of the respondents to the BBA supported leaving the term “reasonable market size” unchanged. It is difficult to see how a definitional change would impact a purposeful manipulation of data because banks with an incentive to skew data do not follow the rules to begin with.

100. *Id.* § 3.8.
101. *See supra* note 78 and accompanying text.
104. *Id.*, § 12.3.
105. *Id.*
106. BBA CONSULTATION, *supra* note 11, § 1.10.
107. *Id.*
108. *See generally* Finch & Livesey, *supra* note 9 (noting the ability of banks to provide unverified data); Verma, *supra* note 102 (describing questions surrounding bank manipulation of LIBOR data).
E. Enhancing Governance and Scrutiny Procedures

The BBA acknowledged that there was a need for an enhanced procedure to assure the validity of the data provided by contributing banks. To accomplish this end, the BBA implemented several key practices, known as the Scrutiny Mechanism. First, the BBA monitors data from banks daily and flags discrepancies including those inputs that “fluctuate, alter rapidly without any obvious external cause, or are not consistent with their market activity in the relevant period within rates.” Second, based upon this flagged data, the FX & MM Committee examines whether a bank’s data is accurate. If the Committee is not satisfied with the data’s accuracy, it asks the suspect bank to explain the data and may request independent analysis. Third, the BBA warns any bank that cannot justify its rates and if the bank continues to provide unjustifiable rates, it will be removed from the panel.

Along with the implementation of this Scrutiny Mechanism, the BBA determined that the FX & MM Committee will be expanded from its current composition of only contributing banks to include non-contributing banks from both Europe and the United States. The addition of non-participants would end the perception, if not the reality, that member banks overlook the transgressions of other member banks. Also, new banks might be more effective and impartial monitors than member banks because they rely on realistic rates being set by the LIBOR process and do not have the same conflict of interest.

Not only would the credibility of the FX & MM Committee be bolstered by increased participation, the Committee would be enhanced by the skill set and knowledge base of non-panel

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110. Id. §§ 13.1, 13.3.
111. Id. § 13.3.
112. BBA REPORT, supra note 3, § 3.2.
113. BBA REPORT, supra note 3, § 13.3.
114. Id.
115. Id.
116. Id. § 13.4. The BBA did not elaborate on which banks would be included or how they would be selected. Id.; Livesey & Finch, supra note 75.
bonds.117 As it relates to the problem created by an outlier rate, the enhanced governance does provide some framework to check rates and punish offenders118 yet the changes in governance do not fundamentally address some reliability issues.119

For example, it is difficult to understand how expanding the composition of the FX & MM Committee or implementing the Scrutiny Mechanism addresses the alleged ‘herd’ mentality120 because the framework does not appear to take into account that multiple banks might be manipulating data or that one bank is manipulating the data to look like the rest.121 That is, the Scrutiny Mechanism is not triggered, nor the FX & MM Committee alerted122 in two situations that have been allegedly prevalent in the current credit crunch: when all rates are skewed (as in when all contributing banks fear being singled out as in financial trouble)123 and when one rate is skewed to align with the rest of the banks (as in when a particularly distressed bank quotes a rate similar to the others).124 Neither of these two situations meet the criteria to trigger an investigation by showing a fluctuation, rapid alteration or inconsistency with market activity.125 In fact, quite the opposite has been alleged to occur in this credit crunch—rates remain grouped together and do not change rapidly for fear of being singled out.126 This new Scrutiny Mechanism, thus, may be able to detect a rogue bank reporting inaccurate data, but it is unlikely to

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118. BBA REPORT, supra note 3, § 13.4.
119. See Krebsbach, supra note 13, at 14 (citing Ann Graham, Professor of Law, Texas Tech University School of Law).
120. See supra note 78.
121. See generally BBA REPORT supra note 3, § 13.3. Neither of these situations would show that a fluctuation or rapid alteration as required by section 13.3 to trigger an investigation would occur. See id. Quite the opposite would happen; rates would remain clustered together and not change quickly. See id.
122. See id.
123. See generally Barr & Twaronite, supra note 6 (describing the fear that banks could have for paying higher rates than their peers).
124. See Mollenkamp & Whitehouse, supra note 59.
125. BBA REPORT supra note 3, § 13.3.
126. See generally supra note 78 and accompanying text (mentioning the problem of ‘herd’ behavior).
detect multiple banks acting as a herd to report false data together.\textsuperscript{127}

V. \textsc{Alternative Solutions that the BBA Should Have Considered}

The BBA was faced with the challenge of balancing transparency, which it considered one of the most important aspects of LIBOR,\textsuperscript{128} with the call for more anonymity to make bank data less susceptible to manipulation.\textsuperscript{129} In addition, the BBA understood that drastic changes to the calculation of LIBOR could lead to potential legal challenges for the trillions of dollars of contracts that rely on LIBOR.\textsuperscript{130}

Of the options considered to increase reliability and confidence in LIBOR, the BBA only adopted the two discussed above: 1) an expansion of LIBOR panels\textsuperscript{131} and 2) an enhancement of governance by adding non-contributor banks to the FX & MM Committee and establishing a Scrutiny Mechanism.\textsuperscript{132} The adoption of these measures does not address the perceived misrepresentation problem.\textsuperscript{133} The Bank for International Settlements stated the problem succinctly, “LIBOR is based on non-binding quotes, as opposed to actual transactions, [and therefore] may open up the possibility of strategic misrepresentation.”\textsuperscript{134}

The President of Euribor ACI, which sets the Euro Interbank Offered Rate,\textsuperscript{135} proposed a different solution that

\begin{itemize}
\item \textsuperscript{127} See supra notes 121-22 and accompanying text.
\item \textsuperscript{128} BBA REPORT supra note 3, § Executive Summary.
\item \textsuperscript{129} Finch & Livesey, supra note 9 (statement by Tim Bond, Head of Asset Allocation Strategy and Barclays Capital) (“LIBOR rates would be more reliable if banks offered rates anonymously, removing the stigma of appearing like they are having trouble accessing capital.”).
\item \textsuperscript{130} Mollenkamp & Norman, Credit Crunch, supra note 89.
\item \textsuperscript{131} BBA REPORT, supra note 3, §§ 8.3, 13.5.
\item \textsuperscript{132} Id., §§ 13.3, 13.4.
\item \textsuperscript{133} See Livesey & Finch, supra note 75 (noting many of the banks recommend fixes to LIBOR including basing the rate on trades rather than a survey, increasing the number participant banks, calculating the rate at a different time and using an anonymous quote); De Vidts, supra note 14.
\item \textsuperscript{135} About Euribor, http://www.euribor.org/html/content/euribor_about.html
\end{itemize}
The President proposed that an independent body should conduct periodic controls on the data submitted by member banks. In other words, the most effective means to ensure reliability is for the BBA to mandate and undertake periodic sampling of actual transacted rates. It is curious that neither the BBA Report nor the Consultation addressed this suggestion.

This proposal has several distinct advantages. First, because the sampling of actual transacted rates would not change the formulation of LIBOR, it would allow LIBOR data to remain transparent and available for public review, something that the BBA highly favors, while improving the accuracy of LIBOR.

Second, the newly adopted Scrutiny Mechanism and the addition of non-contributor banks to the FX & MM Committee would be greatly enhanced by the ability to sample actual transacted rates. By exposing actual transacted rates and comparing them with the rates reported by contributing banks, the BBA could detect and eliminate the two herd behavior circumstances that have been so troubling: when all contributing banks manipulate data for fear of being singled out as in financial trouble and when a particularly distressed bank skews its rate to be similar to the others. Third, sampling actual transacted rates would fit neatly into the BBA’s changes to the Scrutiny Mechanism. That is, the FX&M Committee could play a more substantial role in reviewing the sampled rates and when necessary, question suspicious results.

("Euro Interbank Offered Rate is the benchmark rate of the large euro money market that has emerged since 1999. It is sponsored by the European Banking Federation (EBF), which represents the interests of some 5000 European banks and by the Financial Markets Association (ACI.") (last visited Feb. 8, 2009).

137. Id.
138. See id. (suggesting independent supervision and periodic controls); Finch & Livesey, surpa note 15.
139. See supra note 12 and accompanying text.
140. See supra note 41 and accompanying text.
141. See supra note 111 and accompanying text.
142. BBA REPORT, supra note 3, § 13.4.
143. See generally Barr & Twaronite, supra note 6 (suggesting fear of appearing financially distressed as a motive for banks to manipulate data).
144. See Mollenkamp & Whitehouse, supra note 65.
consistent the approach adopted in the BBA Report.\textsuperscript{145} Repeat offenders would be subject to removal in accordance with the announced changes to the Scrutiny Mechanism.\textsuperscript{146}

Adding periodic sampling of actual transacted rates would not change the actual calculation of LIBOR, it would only change the Scrutiny Mechanism. As such, the sampling would not upset the settled expectations for all current contracting parties who rely on the assumption that LIBOR would continue to be computed as it has in the past. Legal issues would have to be resolved in a situation where a discrepancy was discovered after LIBOR had been calculated and made available to the public. It is unknown whether contracts that rely on this discrepant data would be valid. In addition, the BBA would need to determine whether a LIBOR based on discrepant data would be corrected and recalculated.

Even with unresolved questions remaining regarding a sampling of actual transacted rates, the BBA missed an opportunity to make meaningful steps to assure the validity of LIBOR. As a result, market participants would look to other sources to ensure reliability.\textsuperscript{147}

\textbf{VI. THE IMPACT OF BBA’S INADEQUATE RESPONSE}

From subprime borrowers to global conglomerates, numerous financial actors have a stake in the accuracy of LIBOR because their financial fate is tied to its calculation.\textsuperscript{148} The intense scrutiny that LIBOR has undergone led to relatively minor changes.\textsuperscript{149} Sensing that those who relied on LIBOR were not satisfied with its accuracy, an alternative rate was formulated.\textsuperscript{150} It

\begin{footnotesize}
\begin{enumerate}
\item[145.] BBA Report, supra note 3, § 13.3.
\item[146.] See supra note 115 and accompanying text.
\item[147.] James Quinn & Peter Taylor, ICAP Launches New York Index as Rival to Libor, \textsc{Daily Telegraph (London)}, June 11, 2008, § City, at 5.
\item[148.] See supra note 1 and accompanying text (noting the dollar value of financial instruments tied to LIBOR).
\item[149.] BBA Confirm No Significant Change to LIBOR, \textsc{Banking Newslink}, Aug. 8, 2008.
\end{enumerate}
\end{footnotesize}
was not the BBA who led the charge, but a competitor, ICAP Plc, the largest broker for lender transactions.\footnote{151}

On June 11, 2008, the New York Funding Rate (NYFR) was unveiled\footnote{152} as a response to LIBOR's perceived problems.\footnote{153} It was created to show what banks believed to be the cost of unsecured funding from one another.\footnote{154} This calculation was designed to be purposefully different from LIBOR's measurement, which is the rate at which banks claim they are actually borrowing.\footnote{155} While some commentators thought NYFR was an alternative to LIBOR,\footnote{156} ICAP Plc insisted that NYFR was not a replacement for LIBOR, but rather was a complement to it.\footnote{157}

NYFR is calculated daily with contributors asked "to estimate the cost of funding one-and three-month dollar loans to a representative bank."\footnote{158} The data submissions of participating banks remain anonymous\footnote{159} and the highest and lowest quartiles are discarded.\footnote{160} Unlike LIBOR, the number of contributing banks is not fixed and varies daily, with a minimum of sixteen banks required.\footnote{161}

The calculation of NYFR aims to capture "a generic market rate"\footnote{162} that varies from LIBOR by not publicly releasing a contributor's data submissions.\footnote{163} This methodology shields NYFR from the criticism that LIBOR faces where publicly posting bank

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\begin{itemize}
  \item[151.] Id.
  \item[152.] Id.
  \item[154.] Id.
  \item[155.] Id.
  \item[156.] See McCormick, ICAP, supra note 150; Leong, supra note 153.
  \item[159.] ICAP, supra note 157.
  \item[160.] Id.
  \item[161.] Id.
  \item[162.] Leong, supra note 153 (quoting Lou Crandell, Chief Economist, Wrightson ICAP).
  \item[163.] Id.
\end{itemize}
data submissions has led to charges of bank manipulation of data. ICAP Plc specifically claimed that the anonymity of NYFR ensured the accuracy of its calculation.

Some of the initial hopes for NYFR were realized when the Bank for International Settlements found that NYFR had bolstered the credibility. Between the time NYFR was introduced, in June 2008, and September 2008, the spread between NYFR and LIBOR for three-month maturities has averaged 1.4 basis points. In that period, NYFR has been above LIBOR for the significant majority of days.

The spread between NYFR and LIBOR has not been significant. This could indicate a variety of things: LIBOR is accurate; NYFR eliminated the ability to manipulate LIBOR; the state of crisis in financial markets makes it impossible for banks to post manipulated rates that suggest otherwise. The long-term interplay between LIBOR and NYFR is still unclear, but having a new benchmark rate leads to meaningful choice that no doubt benefits the market.

VII. CONCLUSION

The BBA’s recent revisions to LIBOR did not fundamentally change its calculation and do not address lingering questions about contributing banks’ incentives to provide false information. The history of under-reported LIBOR rates and more recent spectacular jumps in LIBOR, along with the continuing lack of accountability, could be just the thing that pushes LIBOR to the point of absolute unreliability. Market

164. See id.
165. ICAP, supra note 157.
166. NYFR, supra note 158.
167. Id.
168. Id.
169. Mollenkamp & Norman, Credit Crunch, supra note 89.
170. See Mollenkamp & Whitehouse, supra note 59.
171. See Barr & Twaronite, supra note 6.
173. See Finch & Livesey, supra note 15; De Vidts, supra note 14 (suggesting independent supervision and periodic controls).
participants will look to NYFR as a means to enhance or even replace LIBOR\textsuperscript{174} until the BBA implements a system to verify actual transacted rates.\textsuperscript{175} Rather than having LIBOR Left in Limbo, the BBA should act now to rapidly revise the rate.

\textbf{JUSTIN T. WONG}

\textsuperscript{174} See \textit{supra} notes 155-56 and accompanying text.
\textsuperscript{175} See \textit{supra} note 15 and accompanying text.